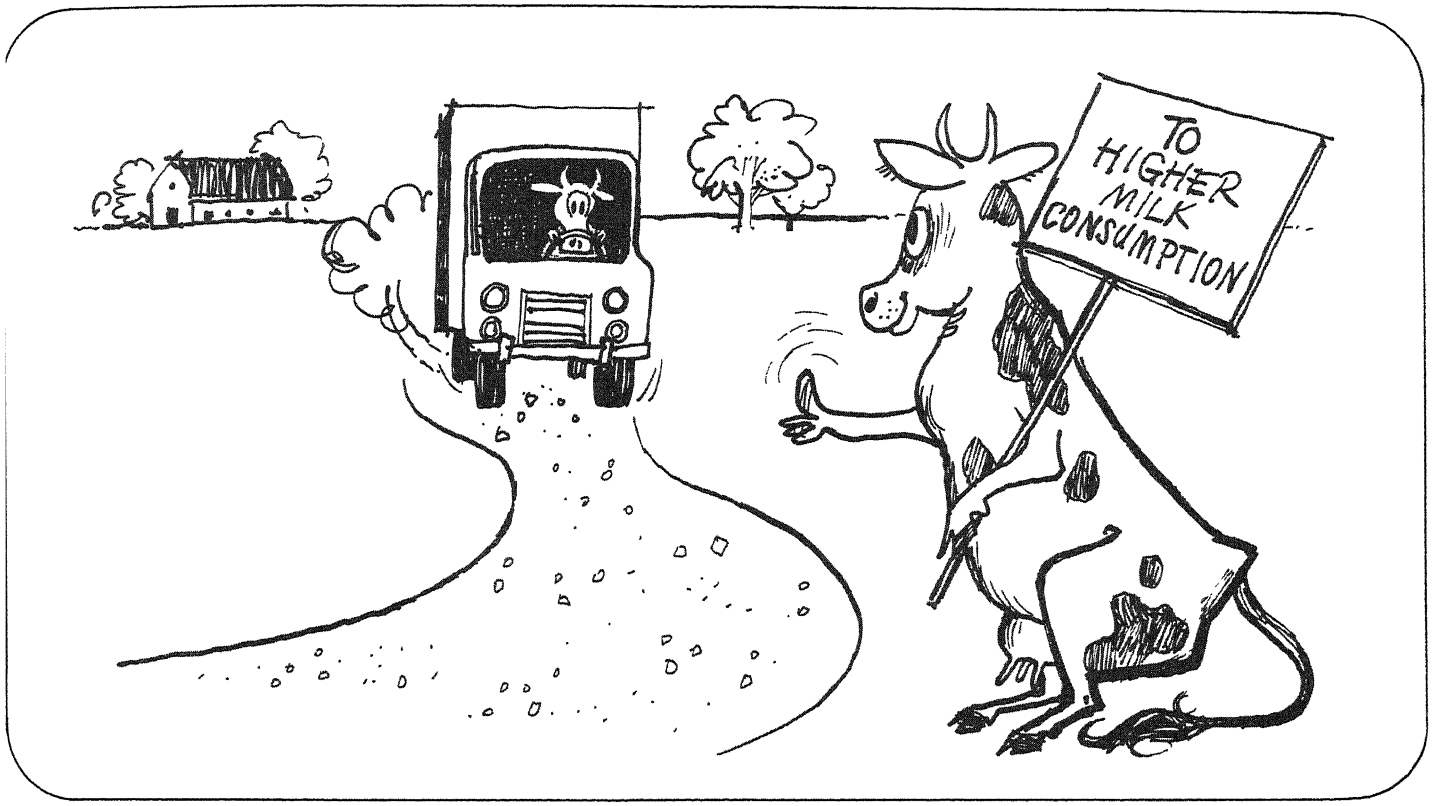
ESM - 460
MM - 310



PROCEEDINGS OF A SEMINAR ON

What's Down the Road in Milk Marketing

COOPERATIVE EXTENSION SERVICE
THE OHIO STATE UNIVERSITY
APRIL, 1971

FOREWORD

Papers presented in this report represent most of the formal part of the program of the fifth Ohio Dairy Seminar, held October 1-2, 1970. This seminar has been sponsored jointly by the Ohio Milk Producers Federation and the Ohio Farm Bureau Federation, in cooperation with the Department of Agricultural Economics and Rural Sociology, The Ohio State University.

Current and projected milk marketing problems were emphasized in this seminar, including regional cooperatives, product classification, the Class I base plan, pooling, bargaining, reciprocity, and standards and labeling. Previous seminars have emphasized the non-member problem as a bargaining limit (1966); merger of cooperatives (1967); dairy marketing policies (1968); and current dairy marketing problems (1969).

The Planning Committee for this fifth seminar in the series included Sam Cashman and William McNutt, Ohio Farm Bureau Federation; Donald Zehr, Ohio Milk Producers Federation; and Robert Jacobson and David Hahn, The Ohio State University.

PURPOSE

It is helpful to review the general purpose of this meeting and try to establish a few bench-marks. This seminar has traditionally invited a relatively small number of leaders rather than having an open type of meeting. Leadership as represented by management and farmer directors have been invited by Ohio Milk Producers Federation and the Ohio Farm Bureau Federation. The dairy marketing specialist staff of Ohio State University has provided guidance and served to coordinate the seminar.

The purpose may be expressed in various ways but it involves the general subject of bargaining and the bargaining position of milk marketing cooperatives. In the past years we have attempted to lift up one or two subjects per year, all related to the question of how milk marketing cooperatives can provide the most effective marketing programs for their members.

The purpose has two points of emphasis:

(1) To acquaint the two groups (OMPF and OFBF) with the current situation and problems in the markets and on the farms, thus enabling them to understand by communicating more effectively with one another.

(2) To study, somewhat in detail, the one or two current problems facing the dairyman and his cooperative and suggest some methods of solving them.

TABLE OF CONTENTS

THE COOPERATIVE'S VIEW ON PRODUCT CLASSIFICATION

George W. O'Brien
Economist
Dairylea Cooperative, Inc.

It would be easy for me to give the cooperative's view on product classification by simply saying "We're for it," and then promptly sitting down. However, I don't think that's what Don Zehr had in mind when he asked me to come out here to talk on this subject. He knows that I've been somewhat involved with classification over the last couple of years, having been on a National Milk Producers Federation committee which attempted to set up some guidelines for the Federal Order program.

Early History

It might be interesting if we first review some of the early history of classified pricing and then, how it has been used recently, where we are at the present, and where we might be going.

I have to start out a little proudly here, because next May will be the 50th anniversary of the use of a classified price and pooling plan by Dairylea. To the best of my knowledge, the Dairymen's Leage Cooperative Association, Inc. was the first dairy farmer organization to sell milk to its many buyers on the basis of how the milk was used, with different prices for each such use, and then pooling the returns from all of these sales so that each member received the same average price for his milk.

They started at that time with five classes of utilization.

Class I was fluid milk.
Class II was fluid cream.
Class III was manufactured products.
Class IV-A was butter, and
Class IV-B was cheddar cheese.

The price was for the whole milk going into these products. With practically all of the producers in the New York Milkshed being members of the Dairymen's League, the blend or uniform or average price brought a substantial amount of stability to the area.

Purpose and Basis

The purpose of the plan, of course, was to stabilize the market and improve dairy farmers incomes. It was recognized that good quality fluid milk on a regular supply basis was worth more to a handler than the seasonally produced milk that went into butter and cheese. The seasonal production, which tended to ruin fluid prices in May and June, contributed to the problem.

Today the basis for milk classification has been translated into economic terms such as elasticity of demand for milk and milk products. This merely means that there is a relatively strong demand for milk for fluid purposes, and therefore it is possible to charge more for that use than for milk for butter. Why? Well, milk is considered almost a necessity for babies and children, and people will pay the price to get it. On the other hand, butter has a substitute in oleomargarine which limits the amount people will pay for butter. Butter is therefore the luxury item, so to speak, and fluid milk the necessity. Most other dairy products fall somewhere between these two extremes.

Breakdown of Program

This plan worked well for the Dairymen's League at the beginning until one large handler, the Sheffield Farms Company, objecting to paying the Class I price for milk, decided that an easy way to obtain a supply of milk for their fluid needs was to entice members of the League to withdraw from the cooperative by offering to pay them 5¢ per cwt. over the League blend. Unfortunately, for all the farmers, members and non-members alike, Sheffield, and then others, did get a supply of milk and the cooperative bargaining power was substantially reduced.

Outside Help

It was at that point in time that state and federal regulation was sought by farmer organizations all across the United States as a means of assisting them in the marketing of their product with buyers in the marketplace.

First, on the Federal level, was the triple A or Agricultural Adjustment Acts of 1933 and 1935 which were declared unconstitutional in 1936. Then in 1937, our current regulation, the Agricultural Marketing Agreement Act, was passed. This is the basis for all of the Federal Milk Orders that have been put into operation over the past 33 years.

It was and is the stated policy of the Act to "maintain such orderly marketing conditions.....in interstate commerce as will establish..... as the price to farmers, parity prices.....".

From a small beginning the order system has grown into a large operation.

In 1969, 144,210 producers had their milk marketed in Federal Order Areas whose population was 122.3 million people. The volume marketed was 61 billion pounds or 52.5% of the 116.2 billion pounds produced last year. The gross dollar value was $3,589,583,000. or $24,891. per producer.

The number of markets reached a peak in 1962 with 83 separate Federal Orders. Last year, through merger, consolidation and extension, the number was down to 67.

The improved marketing practices over time have accounted for the necessary changes or evolution of the order program. Having an impact on marketing practices are such things as:

1. The improved highway system.
2. The improved methods of milk pick-up, bulk tank vs. cans.
3. The improved packaging and distribution practices of handlers, such as plastic coated single service paper vs. bottles, and wholesale store distribution vs. home delivery.
4. Today, handlers serve much broader areas, often over several hundred miles instead of just local retail routes.

The order system has had to accommodate to the changes. Here in Ohio, such accommodation has taken place in the last few years, the most recent ones being the consolidation of the Northeastern Ohio Order, the Greater Youngstown-Warren order, the Greater Wheeling order and the Western part of Pennsylvania into one marketing area with the Clarksburg, W. Va., order added shortly thereafter in the Eastern Ohio-Western Pennsylvania Order; and the more recent merger of the Northwestern Ohio order, the Miami Valley order, the Cincinnati order, the Columbus order and the Tri-State order into the Ohio Valley Order. Previously unregulated territory was included in each of these new orders.

The Order Classification Situation

The classification and pricing for individual markets were originally based upon the situation in the individual market. Generally, milk for fluid purposes that was required to be approved by the local health authorities was included in Class I. All other product uses, not requiring specific health approval, were put in the manufacturing class or classes. However, what was required to be locally inspected in one market and thereby included in Class I, was not necessarily the situation in another market. As the markets have been expanded or merged, because of and together with the increased mobility of milk, the inconsistencies among orders has created problems. The problem arises mainly when a product, fluid or manufactured, is shipped from one market to another.

In an attempt to resolve some of these differences, the National Milk Producers Federation which represents dairy farmer cooperatives all over the United States appointed a committee to study the situation and make recommendations for improvement. At the same time the U.S. Department of Agriculture had a committee working on the same subject.

We found some strange situations among the markets. I'll list some of them.

1. In 20 markets there were more than two classes of utilization.
2. Eight markets classified fluid cream as Class II, the remainder had it in Class I.
3. In 49 markets, eggnog was Class II.
4. Twenty markets classified yogurt as Class II.
5. Seventeen markets classified sour cream as Class II.
6. Thirteen markets provided a higher price for cottage cheese than the basic manufacturing class price.
7. Most orders exclude evaporated milk from Class I, but in making this exclusion the orders provided 26 different ways to do it, that is, there were 26 ways of saying in effect the same thing.

This latter problem has led to a court case recently, the results of which have weakened the classification provision of the Middle Atlantic Order. In attempting to exclude evaporated milk from Class I, that is the regular evaporated milk in consumer cans, the order exempted sterilized milk or milk products in hermetically sealed containers from the fluid milk product definition.

Half-and-half was a Class I product, but the Reddi-Whip Corporation of Philadelphia producing half-and-half in small tetra-pak containers claimed that they were sterilized and hermetically sealed and therefore a Class II product.

The Market Administrator said "No, Class I."

The hearing examiner in a 15-A proceeding said "Yes, it's exempt from Class I."

The U.S. Department of Agriculture Judicial officer reversed the hearing examiner's decision stating that intent of the exclusion from the fluid milk product definition was for evaporated milk in cans and not to be construed to include half-and-half simply because of the container it was in.

The Federal District Judge in the third district reversed the U.S. Department of Agriculture Judicial officer's decision stating that the order language was perfectly clear and that any obscure interpretation not made clear to the regulated handlers would be considered entrapment.

It is obvious from this that we have to be pretty careful in our selection of words, and mean exactly what we say.

The Avoset Food Corporation has recently opened a plant here in Ohio and is selling sterile cream. This product can be marketed over a wide area of many Federal Order markets. Where cream is Class I, this product causes a disorderly competitive situation.

The newly popular product of yogurt presents special problems, being Class I in some markets and Class II in others. One plant, the Carnation Company plant at Fullerton, Calif., distributes yogurt in 38 states. In many cases the product is distributed through brokers or chain stores, never entering a milk plant. It is difficult for the Market Administrator to enforce the price provisions in such circumstances.

Related Problems

Along with inter-order problems caused by differences in classification, are those resulting from price differences or mis-alignment. This has resulted from using different formulas in adjacent or nearby markets for pricing Class I or the manufacturing Class.

For example, many orders in the mid-west use a competitive pay price, the Minnesota-Wisconsin Manufacturing Grade Milk Price Series as a basis for determining the manufacturing Class price. The Ohio markets, on the other hand, as well as those in several other areas, use the Minnesota-

Wisconsin price, but that price has a ceiling on it called a "snubber," based upon actual market values for butter and nonfat dry milk. During the past year, the actual Minnesota-Wisconsin price got more than 40¢ above the snubber. Today it is back in alignment.

Different butterfat differentials in neighboring markets can also result in different costs to handlers even though the product is in the same class. For example, the Class II butterfat differential in the Eastern Ohio-Western Pennsylvania market is based upon the Chicago 92-Score butter price, and the New York-New Jersey market price is based upon the New York butter quotation. With the New York butter price averaging about one cent over Chicago, the butterfat differential between the two markets usually differs about one-tenth of a cent. When translated into the cost of the ingredients in a can of 40% cream, the difference is about 30¢ higher for New York-New Jersey, even though the Class II prices are about the same.

Our committee on classification recognized that we had to get away from reliance on health regulations as a basis for classification and move to a broader standard that would be applicable throughout the order program. The Marketing Agreement Act only provides us with the language "Classifying milk in accordance with the form in which or the purpose for which it is used."

Actually the Department of Agriculture had already relaxed its reliance upon health regulations when it stated in a 1968 New York decision that "milk used to produce other fluid milk products for which handlers generally and regularly rely on local producers for milk supplies, which product competes directly with those fluid products for which an approved supply source is required, should be classified as Class I milk."

In 1969 the U.S.D.A. issued a decision of Filled Milk. This is the product made from a vegetable fat and either skim milk or reconstituted non-fat dry milk. The decision, which is the result of a National Hearing on all the orders, put the skim milk or the nonfat dry milk, whether it came from order producers or from thousands of miles away, in Class I. It stated in part:

> "The form of filled milk and the purpose for which it is used are the same as the form and purpose of use of whole milk. Filled milk, just as whole milk, is disposed of in fluid form. It is marketed by handlers in the same types of packages and in the same trade channels as the whole milk they market, and is mainly intended as a beverage substitute for milk."

In a booklet describing the order program, the Department of Agriculture describes classified pricing as follows:

> "An order establishes prices by classes according to the use of milk. Because milk is perishable and is subject to contamination, there is extra cost of sanitary control on the farm, such as the expense of refrigeration and necessity of frequent

delivery. Because it is bulky, there is a high cost involved in hauling it to market. This makes milk for fluid purposes cost more than milk for manufacturing purposes, and a higher price must be paid to encourage its production. Also, sales of fluid milk are fairly even the year round, while production is seasonally higher in the spring than in the fall. When producers deliver enough milk in the fall to meet fluid consumption, they generally deliver more than is needed for fluid uses in the spring months. The milk used for fluid consumption is priced at a lower level in line with the value of the manufactured dairy products made from such milk."

Note the omission of any reference to health regulations.

Recommendations

The recommendations by the Federation Committee on Classification were general in nature so that there could be some variation by areas or regions to reflect specific marketing differences that may exist. However, we recommend the following:

1. A common definition for "fluid milk product."

2. Three classes of utilization with:
   Class I to be all fluid milk products.

   Class II to include all of the "soft" manufactured products such as ice cream, soft cheeses, evaporated and condensed milk, soup and candy. In addition, cream and half-and-half would be Class II, this to reflect the decreased demand for cream, to make it more competitive with the so-called sterile products, and solve the problem of trying to regulate sterile cream in Class I.

   Class III to include primarily the products under the price support program such as butter, nonfat dry milk and cheddar cheese.

3. We would propose a single butterfat differential for all classes of utilization using 11½% of the Chicago butter quotation. This will lower the differential for Class I for most markets, but this will increase producer returns since the butterfat content now in most markets, with the low fat milks, is below 3.5%. This would also improve the competitive position of butterfat and improve inter-market price alignment of milk ingredients.

   Incidentally, that 11½% may have to be changed if the current Farm Bill is passed by Congress and signed into law by the President. The 11½% as applied, reflects the difference in value between 1/10th of a pound of skim milk as contrasted to 1/10th of a pound of butterfat. The Farm Bill will remove the requirement to support butterfat in farm separated cream

so that in the future, under the dairy price support program, it will be possible to further differentiate in the relative values of butterfat and skim milk while at the same time remaining within the 75 to 90% of parity limitations.

4. As to price of the three classes, we have already treated with Class I in the National hearing last January, where cooperatives from every market order in the country joined together through the National Milk Producers Federation in proposing an economic formula as the basis for moving prices up or down in unison in all the orders.

   For Class II we recommended a price of not less than 15¢ over the Class III price, but depending upon the situation in the specific market or region.

   We said that the Class III price should reflect or make allowances comparable to those used by the U.S.D.A. in establishing purchase prices for butter, nonfat dry milk, and chedder cheese under the price support program.

The First Classification Hearing

The first hearing to generally consider the classification problem was held in July in St. Louis and was for seven mid-west markets. Proponents were the three giant new cooperatives, Associated Milk Producers, Inc.; Mid-America Dairymen, Inc.; and Dairymen, Inc.

Their hearing proposals followed closely the recommendations of the Federation committee, but deviated sharply on price. All but one of the markets was using the Minnesota-Wisconsin price series as the basis for the Class II price. Indiana was using the N-W price series, but was limited by the butter-powder formula as used here in Ohio and the Northeast.

The co-ops proposed Class III at the Minnesota-Wisconsin price level, and Class II at 10¢ over that figure.

This, of course, is of serious concern in the Northeast because practically all of the milk in the region is pooled in some order and substantial quantities, at times, is used in the butter, powder, cheese category.

Frequently the competitive situation in the Minnesota-Wisconsin area causes the pay price for manufacturing grade milk to be artificially high relative to market values. As an operating cooperative, doing the balancing for the market, we make these products as required by the supply-demand situation. An artificially high price for milk used in these products, causes an operational loss and a payment or return to our members that is low relative to that paid by the proprietary handlers or bargaining type cooperative serving the fluid handlers exclusively. We recognize the need for balancing to promote market stability, but we are also interested in all producers sharing in that cost. Artificial prices do not increase producer returns, they only create disorder among producers because of producer price differences.

In the Chicago Regional Market, the relatively high price of the Minnesota-Wisconsin price series is used for the manufacturing class to discourage the association of too much milk with the market. The situation is therefore different than in the Northeast.

Another thing that came up at the hearing were arguments that certain products should be Class III rather than Class II. These included such items as ice cream, evaporated milk and the cheeses such as Colby and Monterey which are practically indistinguishable from cheddar. Some of the arguments were well founded and the answers don't come easy.

The Ohio Approach

While our committee was working and the problem of classification was being discussed, the U.S.D.A. was going on with business as usual, and here in the Ohio area a fairly important change in classification and pricing has just recently been included in both the Ohio Valley and the Eastern Ohio-Western Pennsylvania orders.

Cream has been taken out of Class I and put in Class II.

The fluid milk product definition (Class I) makes no reference to sterilized products in hermetically sealed containers.

Class II, in addition to cream, includes cream and milk or skim milk mixtures down to 10.5% butterfat, yogurt, sour cream and sour cream products (dips), cottage cheese and cottage cheese curd, and milk to a commercial food processing establishment for the manufacture of packaged food products.

Class III is the remainder, including frozen desserts, eggnog, frozen cream, butter, cheese, evaporated and condensed milk, nonfat dry milk, dry whole milk, dry whey and dry buttermilk.

In pricing these products, Class II is priced at 10¢ over the Minnesota-Wisconsin price series and Class III is priced at the Minnesota-Wisconsin price but limited by the butter-powder formula.

Comment

If Class II is limited to a few of the soft manufactured products as is now being done here in Ohio, then the pricing may withstand the rigors of marketing. However, if several additional products are included in Class II, I believe there needs to be a fairly close, calculated relationship between Class II and Class III.

In our particular market, the single true surplus product is butter and nonfat dry milk. The production of everything else is quite steady year to year, even cheddar cheese. We have considered the possibility of proposing only butter and nonfat dry milk in Class III with everything else in Class II. Currently, we are waiting for a recommended decision on the St. Louis hearing before taking up the total proposition in the Northeast. We recognize from a coordination or alignment standpoint that the classification and pricing approach will have to be fairly uniform throughout the order program.

Conclusion

In my opinion, we would do well to continue to work together through the National Milk Producers Federation to arrive at a common approach to classification and pricing. If we can't make these decisions for ourselves, someone else will make them for us.

We do need to maintain a sound basis for classifying milk, for much of the additional income that dairy farmers receive, over and above the manufacturing price, is dependent upon its continuance in the order program. I think it's safe to say that co-ops favor the continuance of product classification.

THE PUGET SOUND CLASS I BASE PLAN
-- A CURRENT LOOK --

Hollis A. Hatfield
Assistant Director, Research Division
American Farm Bureau Federation

The Class I base plan under the Puget Sound, Washington, Federal Milk Marketing Order No. 125 went into effect on September 1, 1967. We have, therefore, a market with three years of experience under a Class I base plan to observe. To date, Puget Sound is the only Federal Order Market with a Class I base plan authorized by the Food and Agriculture Act of 1965.

In any review of the Puget Sound Class I base plan, it should be emphasized that the Puget Sound area is unique, as compared to most Federal order markets: that is, the movement of milk is deterred by Canada on the north, mountains on the east, and an ocean on the west.

What is a Class I Base Plan?

A Class I base plan apportions fluid milk sales among the dairymen shipping to a particular market based upon each dairyman's past deliveries to that market.

Historically, most base plans have been "seasonal" plans designed to solve the short-run problem of annual seasonal variations in milk production. Frequently confused with the Class I base plan, seasonal plans are designed to achieve an improved supply-demand balance throughout the year by reducing seasonal variations in milk production, rather than to give each producer a fixed share of the Class I market.

Under the Puget Sound Class I base plan, each producer established a "production history base" determined from the highest daily quantity of milk delivered during a designated period. An adjustment factor of 55.7 percent, determined from the amount of milk needed for Class I sales plus the Federal Order reserve requirement, was then applied to each producer's "production history base" to determine the base to be issued to each producer.

Example:

Producer's "production history base"	2,537 pounds
Adjustment factor	.557
Base issued	1,413 pounds

Bases

Between September 1, 1967 (date base was issued) and December 31, 1969, the average size of base increased from 925 to 1,413 pounds - a 53 percent increase. This change, caused largely by the withdrawal of producers who sold their bases, concentrated the issued base among fewer producers.

On September 1, 1967 there were 12 Puget Sound producers with bases of 5,000 pounds or larger and one producer with a base of 10,000 pounds or larger. By December 31, 1969, these numbers had increased to 42 with bases of 5,000 pounds or larger and five with bases of 10,000 pounds or larger.

The argument is advanced by some that a Class I base plan favors the larger and more adequately financed dairymen because of the capital required for the purchase of base. Although this argument probably is true, it is difficult to isolate such a factor from the general trend toward bigger and fewer farm units.

It probably is fair to state that the Class I base plan, by encouraging some producers to leave the dairying business sooner than they otherwise would has accelerated the trend somewhat toward larger and fewer farm units in the Puget Sound Marketing Area.

Under the Puget Sound plan, a producer's base (issued base) is frozen at the level determined when the plan was established. A base not subject to change is a "closed" base. Under a base plan with a "closed" base, the only way producers can obtain base is by purchase. An "open" base provides for a change in a producer's base on an annual, or some other predetermined period.

The legislation now pending before Congress (hereafter referred to as revised legislation) provides for an "open" base with automatic updating each year. A bill introduced by a Congressman from the state of Washington permitted updating of base by a moving average or a rolling base. Either of these proposals would permit new producers to enter the market and to attain equality with established producers with respect to Class I bases. Annual updating, however, using the most recent period of production, might cause a Class I base plan to be undermined as has happened to many seasonal base plans; that is, dairymen might produce increasing quantities of milk for the lowest classification use to protect their share of income from Class I sales. A rolling base would prevent such a situation from arising.

The Puget Sound Class I base plan authorizes the transfer of bases among producers at the going market price. During the past three years of operation, Puget Sound producers paid an estimated average price of $10 to $14 per pound of base. The revised legislation authorizes the Secretary of Agriculture to establish "terms and conditions...which will prevent bases taking on an unreasonable value." Such language injects a judgment factor that might lead to under-the-table dealings if the Secretary should attempt to limit the price of base to less than its economic value.

Base and Blend Prices

A Class I base plan does not add to or subtract from the total money paid producers for a given quantity of milk. In brief, the money is merely divided among dairymen in a different manner.

Comparing producer prices during the first year of the Puget Sound base plan to the blend pricing method, the average return per hundredweight

for the total market would have been the same for all milk delivered (Table 1). If there had been a significant reduction, for example, in producer deliveries during this period, as compared to actual deliveries, there would have been a decrease in the total money paid producers. The average return per hundredweight for the total market, however, would have been higher under both the blend and the Class I base pricing methods.

Table 1. Producer Prices Under Base Plan and Blend Pricing Method Compared, Puget Sound Marketing Area, September - August 1967-1968

Puget Sound Base Plan Price			
Milk	% of Total	Price ($/cwt.)	Value ($/cwt.)
Base	60.94	5.68	3.46
Excess	39.06	4.02	1.57
Total	100.00		$5.03 per cwt.

Puget Sound Blend Price			
Milk	% of Total	Price ($/cwt.)	Value ($/cwt.)
Class I	49.18	5.99	2.94
Class II	36.25	4.10	1.48
Class III	14.57	4.18	.61
Total	100.00		$5.03 per cwt.

Pricing

The classification system of pricing milk is not eliminated under a Class I base plan, nor is the method of determining handler payments for milk changed. The handler must account by classes for the milk used and must pay into the pool a sum equal to the volume used in each class times the respective class price.

The Puget Sound Class I base plan provides that milk delivered by a dairyman be divided into two categories: "base" milk and "excess" milk. The producer received a higher price for base milk, as compared to excess milk -- the lowest use classification, Class III (Table 2). The amount of base milk a dairyman can market is limited; no limitation, however, is placed on the volume of excess milk that can be marketed.

Table 2. Prices By Class, Base, and Excess, Puget Sound Marketing Area; January - August, 1970 1/

Month	Class I	Class III	Base	Excess
	Per 100 pounds of 3.5 percent milk			
January	$6.48	$4.25	$6.18	$4.25
February	6.52	4.26	6.21	4.26
March	6.48	4.27	6.24	4.27
April	6.43	4.58	6.19	4.58
May	6.45	4.58	6.16	4.58
June	6.43	4.61	6.14	4.61
July	6.46	4.60	6.13	4.60
August	6.45	4.61	6.16	4.61

1/ Effective May 1, 1968, the number of classes for pricing purposes was changed from two to three. Class II includes milk used for ice cream, cottage cheese, and condensed milk; Class III includes milk used to manufacture butter, powder, evaporated milk, and hard cheeses. Class II price is 25 cents per cwt. above the Class III price. The 25 cents is distributed to producers through the excess location adjustment; does not affect the base price.

Many dairymen have the impression that the base price is the Class I price. Largely because of the reserve requirement in a Federal milk marketing order, the base price is lower than the Class I price (Table 2). Under the Puget Sound base plan, about 85 percent (annual basis) of the base price is determined by the Class I price. The price a dairyman receives for his base milk, therefore, is more accurately expressed as the base "blend" price; the blend price derived primarily from the volume of base milk used in Class I and Class III times the respective class price (Table 3).

Table 3. Base "Blend" Price Computation

Class I	Sales -- 81.78% of base milk used as Class I	
Class III	Sales -- 18.22% of base milk used as Class III	
Class I	Price -- $6.45 x 81.78% =	$5.27
Class III	Price -- $4.61 x 18.22% =	$0.84
	Base "Blend" Price	$6.11

Translating base and excess prices into prices by classification, a dairyman with a 1,413 pound base would have received the Class I price for 1,156 pounds and the Class III price for 257 pounds for the month the computations are shown in Table 3.

A dairyman with an average daily delivery of 2,537 pounds and a base of 1,413 pounds for the month shown in Table 3 would have received the base price for 56 percent of his total deliveries (the Class I price for 46 percent of his total deliveries).

WEIGHTED AVERAGE PRICE

The weighted average price is determined from the percentages the base and the excess milk are of the total producer deliveries. For example, in July 1970 producer deliveries in the Puget Sound marketing area were comprised of 52.61 percent base milk and 47.39 percent excess (Table 4). The base price was $6.13; the excess price $4.60 (Table 1). The weighted average price for all milk in July was $5.38 (Table 4).

Table 4. Weighted Average Price Computation, Puget Sound Marketing Area; July 1970

Base Milk	-------	52.61% of producer deliveries
Excess Milk	-------	47.39% of producer deliveries
Base Price	-------	$6.13
Excess Price	-------	$4.60

$6.13 x 52.61	=	$3.21
$4.60 x 47.39	=	$2.17
Weighted average price for July		$5.38

In July, a dairyman who delivered a daily average of 2,537 pounds of milk received the base price for 56 percent of his deliveries; the excess price for 44 percent. His weighted average price was computed as follows:

Base price	--	$6.13 x .56 = $3.43
Excess price	--	$4.60 x .44 = $2.02
Weighted average price	--	$5.45

Note that in the above example, this dairyman received a weighted average price for his milk in July that was seven cents per hundredweight above the average for the total market (Table 4).

Three Reasons For A Class I Base Plan

Three reasons frequently advanced for a Class I base plan are:

1. To reduce surplus milk production;
2. To eliminate a basic defect of the blend pricing system; and
3. To permit a dairyman to produce in line with his market's fluid requirements.

Let's take a brief look at these reasons, using as our guide market statistics for the three year period the Class I base plan has been operating in the Puget Sound Marketing Area.

* * * * * * *

To reduce surplus milk production is the most frequently stated reason for a Class I base plan. This reason is also a statutory objective for use of a Class I base plan under a Federal milk marketing order.

The amount of milk delivered by producers the first year of the base plan was 30 million pounds below deliveries for the comparable period the year prior to the plan -- a 2.3 percent decline. Producer deliveries totaled 1,265 million pounds during the second year of the base plan and moved up to 1,344 million pounds in the third year - seven percent above the volume of milk delivered during the first year of the base plan (Table 5). Plant changes had only a slight effect on these figures.

Table 5. Producer Milk Deliveries and Class I Utilization, Puget Sound Marketing Area: September-August 1966-67, 1967-68, 1968-69 and 1969-70

Period	Deliveries	Class I Utilization
	mil. lbs.	percent
1966-67 (year prior to Class I base plan)	1,286	47.4
1967-68 (1st year)	1,256	50.6
1968-69 (2nd year)	1,265	51.9
1969-70 (3rd year)	1,344	49.0

In the year preceding the base plan (September, 1966 - August, 1967), the Class I utilization in the Puget Sound market averaged 47.4 percent of producer deliveries (Table 5).

During the plan's first year, the Class I utilization averaged 50.6 percent of producer deliveries - 3.2 percentage points above the comparable period in 1966-67 (Table 5). This increase in the Class I utilization resulted from:

A. The decline in producer receipts (2.3 percent); and
B. The increase in Class I sales (4.5 percent).

The Class I utilization rose to 51.9 percent in the second year of the base plan and dropped to 49 percent in the third year (Table 5).

During the first eight months of 1970 the Class I utilization continued to decline, as compared to the same period in 1969, dropping in June to 39.9 percent; the first month below 40 percent in more than four years.

Looking at producer deliveries in the Puget Sound Marketing Area for the first eight months of 1970, the increase of 7.9 percent above the comparable period in 1969 was pronounced. The increase for the U.S. during the same period was less than one-half of one percent (Table 6).

Table 6. Producer Deliveries and Percentage Change, Puget Sound Marketing Area; January-August Period 1967-70

Eight Month Period	Producer Deliveries	Percent Change From Prior Period	
		Puget Sound	U.S.
	mil. pounds		
1967	868	-	-
1968	847	-2.4	-1.5
1969	860	1.5	-1.4
1970	928	7.9	0.4

Producer deliveries in the Puget Sound Marketing Area during the first eight months of 1970 totaled 81 million pounds above those for the comparable period in the first year of the base plan (Table 6).

Dividing producer deliveries into their component parts, base and excess, base deliveries for the first eight months of 1970 were 2.5 percent below those for the same period in 1969; excess deliveries rose 24.5 percent (Table 7). It is difficult to pin down why some producers continue to ship below their base. Under the Puget Sound plan, a producer does not lose any base if he fails to deliver his entire base in any one month. The revised legislation contains a "may" provision for reducing a producer's base if the producer does not deliver his entire base.

Table 7. Producer Base and Excess Deliveries and Percent Change; Puget Sound Marketing Area, January-August Periods 1969 and 1970.

Eight Month Period	Producer Deliveries		Change in Producer Deliveries from 1969	
	Base	Excess	Base	Excess
	million lbs.		percent	
1969	529	331	-	-
1970	516	412	-2.5	24.5

Producers with no base, approximately one-fourth of the dairymen, accounted for over 25 percent of the total producer deliveries to the Puget Sound market during the first eight months of 1970. These producers received the base price for an average of 18 percent of their deliveries and the excess price for 82 percent. Translating these figures to a Class I pricing basis, these producers received the Class I price for about 16 percent of their deliveries.

Under the Puget Sound plan, base is assigned to new producers for pricing purposes only. The revised legislation stipulates that within 90 days after beginning delivery at the price for the lowest use classification, new producers shall be allocated base as determined proper by the Secretary of Agriculture.

The Class I base plan objective to reduce surplus milk production is based on the assumption that it is unprofitable for most dairymen in fluid markets to produce milk for manufacturing purposes.

Regardless of the so-called new producer provision of the Puget Sound plan, the fact remains that the "excess" price is high enough to induce production for manufacturing purposes. With the excess price being largely determined by the price support level, the support level not only is high enough to induce production of excess milk, or overbase milk, but has undermined the base plan.

Quoting from a recent California dairy publication on that state's base plan: "...the increase in the support price has upped the manufacturing milk price enough for most dairymen to think it is profitable to produce overbase milk...Without any doubt, the existing excess production will weaken the California Base Plan and probably deter any increase in price to procurers..."

* * * * * * *

To eliminate a basic defect of the blend pricing system is a second reason often stated for a Class I base plan.

The Puget Sound Class I base plan, with its two-price structure, does eliminate the so-called subsidized production of surplus milk but it does not entirely prevent the increased production of other dairymen from lowering the base price paid a producer because the base price is a blend of the Class I and Class III or excess price.

* * * * * * *

To permit a dairyman to produce in line with his market's fluid requirements is a third reason frequently given in support of a Class I base plan.

The Puget Sound Class I base plan does permit a dairyman to produce in line with his market's fluid requirements by assigning him a base representing his proportionate share of the Class I sales during a stipulated base forming period. The plan also permits a dairyman to increase his original share of the market's fluid requirements by the purchase of base.

Although the Puget Sound plan has met the test of this third objective, on close examination a major question can be raised: that is, at what level should a market's fluid utilization be to assure a dairyman an adequate income? I raise this question because the Class I utilization in the Puget Sound Marketing Area for the first eight months of 1970 averaged 46 percent.

Other Amendments

The 1965 Act authorized bases for individual producers and associations of producers thus permitting a cooperative with its own base plan to maintain the same relationship among its members as to their bases if a Class I base plan were approved under a Federal milk marketing order. The revised legislation contains authority for only individual producer bases.

The revised legislation contains new language stipulating the assignment of other source milk to various use classes shall be made without regard to whether an order has a Class I base plan. This language is interpreted to mean that Federal order markets with a Class I base plan can not down-allocate (change from Class I to Class II or III) packaged or bulk milk received from other order plants.

Probably the major change in the revised legislation among those changes that I have not covered is what is known as the "Zwach" (Congressman from Minnesota) amendment. This amendment provides that a dairyman upon becoming a producer under an order shall after 90 days be allocated base on the same basis as other producers. In effect, this amendment means that a producer after shipping to any Federal order market with a Class I base plan for 90 days at the excess price, shall be issued base determined from his production history on the same basis as producers under the order.

Unlike the base plan legislation authorized by the Food and Agricultural Act of 1965, the revised legislation stipulates that provisions shall be made in the order for the allocation of bases to new producers and to producers coming under the Zwach amendment. It would appear that any base plan developed under the revised legislation, unlike the present Puget Sound Plan, would have to contain authority for reducing producer bases if additional base should be needed to comply with the act.

Summary

In summary, my remarks can be boiled down to two points:

1. The effect of the Puget Sound Class I base plan upon the average price received by producers --

   A Class I base plan does not add to or subtract from the total money paid producers for a given quantity of milk. The money is merely divided among dairymen in a different manner.

   A study by the Market Administrator for the Puget Sound Federal Milk Marketing Order shows that for the period reviewed, 51 percent of the producers received a higher average price under the Class I base plan than they would have received on the basis of the uniform blend price; 49 percent received a lower average price.

What the Class I base plan boils down to for the individual producer is a determination of which group he thinks he will be in.

2. Role of Price --

With or without a Class I base plan, price will continue to play the predominant role in balancing a market's needs. As one producer advocate of the Puget Sound plan remarked: "If the excess price is at a level where a producer can break even or make a few cents, the surplus in this market will not be greatly reduced."

Anyone who is serious about using a Class I base plan, authorized under a Federal milk marketing order, to reduce surplus milk production must give thought to how the excess price can be set at a level that discourages the production of such milk in large volumes.

WHAT'S AHEAD IN MILK MARKETING?

Hugh L. Cook
Professor, Agricultural Economics
University of Wisconsin

I want to begin this with a summary of the flow of strategic events in the dairy world and problems of the last two decades. The past is prologue to the present and the future as well. My list includes, not in order of importance:

1. The threats of shortages and of inflation caused by the Korean War. Then the dawning realization that the Korean War had little effect on dairy markets and worst of all high consumer incomes did not clear dairy markets.

2. The question of what went with our out of state markets for fluid milk after the fall of 1948? Something must be erecting barriers, perhaps the inspection procedures, perhaps the federal order system through compensatory payments, for example.

3. Gradual erosion of legal barriers such as in the Dean milk case.

4. Reciprocal inspection.

5. Impact of technological innovation such as:
   (a) Automation
   (b) Bulk tanks
   (c) Paper packages and gallon jugs
   (d) Milk dispensers and vending machines.

6. Structural changes especially in retail-store handling.

7. The bobtailer and the captive milk store.

8. Impact of the private label.

9. Price cutting and price wars all over the place. A development from this was the tremendous growth in number of federal orders.

10. The development and near passage of a self-help plan.

My list of problems and strategic events for the 1960's includes, again not in order of importance:

1. The fact that Kennedy showed little signs of <u>wanting</u> to get a dairy program through Congress which warned us that the best political machines were consumer oriented.

2. Growth in strategic importance of the President's Council of Economic Advisors.

3. The turn-around in milk production.

4. The appearance of the conglomerate firm. Borden lost interest in dairying, and national firms showed declining interest. This carries a dramatic message on who must create demand, as Gerald Quackenbush pointed out.

5. The record number of mergers in all lines. History had seen nothing like it.

6. The regional federations and mergers of coops.

7. The renewed interest in farm bargaining, especially as evidenced by the Mondale Bill.

8. The accelerated conversion to Grade A.

9. New dimensions to the import problem.

10. The build up of record surpluses abroad.

11. The marketing of imitation and substitute milks as a practical threat.

12. The first national hearing on milk orders.

13. The astounding increase in investment required for dairy farming.

There were transitional problems of course, but essentially we had adjusted to, or knew what to expect from, several of the things which occupied us so much in the 1950's.

Now what are essentially the new concerns as we enter the 70's? Well, I expect most of them are things that surfaced during the 60's but things we did not master or work out a satisfactory way with which to live. Again I shall not try to name these in the order of their importance. All of these things must be on the agenda and must be moved up or down and played in a higher or lower key depending on the support that we can get in the process of making public policy. They follow:

1. To adjust to the rapid conversion of grade B to grade A. This can be done for example by (a) Orderly absorption of it into grade A markets. Devices such as the standby pool will be a big help. (b) Slowing down the conversion rate from Grade B to Grade A. Devices include a national order for all milk, worked out in such a way as to allow Grade B producers to share in Grade A returns. National milk boards are another device by which this could be achieved.

2. To provide adequate funding of research and development, and promotion. It could be argued that farmer check-offs for this purpose should be mandatory. We know by now that the big national corporations are turning away from dairy products and we can no longer depend on them to carry the major part of the burden.

3. To re-examine laws which inhibit new product development. We also should re-examine those many regulations which cause our costs of producing,

processing and handling milk in the U.S. to be about the highest in the world despite our vaunted efficiency.

4. To improve price alignment among markets. I don't think we can do this just by dabbling with freight differentials out of Chicago. Ideas such as one national Class I price FOB the farm, with the handlers paying the costs of hauling, are working us in that direction.

5. To work out some form of supply management which seems just as necessary as it did when milk production was 125 billion pounds per year, though the form it should take may differ. A shrinking to 108 billion pounds in the next few years has been forecast officially but the decline in consumption and the rapid conversion to grade A will cause even 110 billion pounds to give us trouble. Besides that the milk production trend may turn around, especially if we get a fall in beef prices.

6. We need new pooling devices.

7. We need new methods of financing on commercial farms. Investments in dairy farming are so great now that we must come up with new methods of getting the use of land and other resources into the hands of commercial farmers. The farm labor problem is closely related to this, as are problems of farm organization and problems of vertical integration.

8. Nearly all our problems could be approached through the large regional cooperative. We have little experience with coops of this size, especially in milk. A great surge of energy will be required to make them fulfill the promise we have held forth. We have promised improved efficiency, more effective bargaining, more effective participation in the governmental process, greater equity for producers and such. We are blessed by leadership with flare and imagination to put these big coops together but the pedestrian jobs still have to be done. There are new possibilities of systems effeciencies as a result of this new method for organizing the industry but we know little about them. Because of the regional cooperatives we now have a small number of decision making centers and decisions become possible that never were before. We can use them as the institution through which to reshape all our policies. We could use them, for example, as a method of administering the price and income program for the dairy industry. There is reason to believe that a national self-help program is far more practical now than ever before.

Selected structural features of the dairy economy follows:

1. Dairy farm numbers are falling rapidly.
   a) Tremendous increase in investment to eke out all possible from family labor.
   b) Fast yielding technology used up on medium and large farms.
   c) Elasticity of production response to farm price appears to be about one-half what it was a decade ago.
   d) Grade A conversion.

2. Phenomenal development in regional federation and merger of coops especially in the last six years.

They may be approaching same cross roads.
a) As to further growth by merger.
b) On processing.
c) On manufacturing.
d) Etc.

3. The relevant market has greatly expanded in size.
   a) Procurement market in manufacturing.
   b) Procurement and selling market in packaged fluid.

4. The number viable fluid processors has been cut in half in a decade.

5. Chain stores heavily in manufacturing and processing. Perhaps 20 percent packaged fluid now packaged by retail chains. May have to include captive processors to get that figure.

6. Buyers for fluid packaged milk and ice cream no longer explain atomistic.

7. Large national dairy companies and perhaps regionals to some extent are conglomerating.

I expect that your program committee wants me to speculate a little on a few major questions of the day. Here are some speculations.
a) Will the regional mergers slow down or begin to bog down?
b) Who will package and handle fluid milk?
c) Can the free rider problem be handled?
d) Will we get a better relationship between grade A programs and those for milk used in manufacturing?
e) Can the manufacturing industry substantially improve its efficiency?
f) What may we expect by way of demand?

Some people are predicting that regional mergers will slow down in the next three years. Will they? I think that the people who are predicting this may be using it as a way to persuade their members and perhaps others to take certain merger actions which they think are desirable. In other words, gather your roses while you may. They say, in effect that the Justice Department and the Federal Trade Commission have not proceeded against the regional mergers or any of their conduct so far, because of their assumed immunity under the Capper-Volstead Act, but that now that they are becoming large and the public is noticing them, there may be some reinterpreting of this immunity in the near future.

Well there may be some slowing down but I see nothing ahead that I think should stop them. Coop mergers apparently have been viewed as voluntary actions of producers and not as a merger in the usual sense. MacIntyre that was Chairman of the Federal Trade Commission in recent years, according to the reports I hear, was quite friendly toward cooperatives and toward seeing them grow either by internal growth or by merger. We don't yet know how Miles Kirkpatrick, the new Chairman of the FTC, may view them.

There is reputed to be some lawyers in the Justice Department who would like to see test cases brought under the Capper-Volstead Act, not necessarily to hamper merging cooperatives, but to find out how certain actions might be interpreted under the language of the Capper-Volstead Act. You will recall that in the mid 50's the U.S. Attorney General issued a report which included his interpretation of the immunity enjoyed by cooperatives under the Capper-Volstead Act. He concluded that section with the observation that in 50 years the Secretary of Agriculture had not found in any instance an undue enhancement of prices because of the actions of cooperatives. He recommended that the administration of the Capper-Volstead Act be removed from the Secretary of Agriculture and placed elsewhere in government. I suppose we may interpret this one thing that may be noticed by Kirkpatrick, the new FTC Chairman. From all I can hear, although I am not a lawyer, I can't find anything that will cause the leaders of these regional cooperatives including the federations to stop their drive toward regional mergers. With all the momentum that has been built up and considering the nature of the leadership, they, of course, would like to avoid direct confrontation with the Justice Department of FTC.

Now there may be something other than law that will tend to hamstring the new regional cooperatives and slow down the momentum and that is the nature of their problems. The two biggest ones that I see are (1) the communications problem which I named above. They are working on this and I don't see anything about it that can't be solved, howbeit there are no good precedents for solving some facets of the problem simply because we never had consolidated coops on that scale before. (2) The non-member problem. This is a very very critical one at this time. For example, in several areas the new regional cooperatives had been unable to negotiate super pool premiums or indeed keep the ones they had because of the non-member problem. To remedy this they are working on a bargaining bill and I would predict that with the force behind it, they may get one within the next few years. If they do get one of the type that some people are talking about, it will mean that if more than say 50 percent of the producers can be put together in a particular market situation then these may represent the entire market in bargaining with the handlers and that whatever price they may arrive at will be enforced by the Secretary of Agriculture on all handlers. A bill of this type could solve the non-member problem.

There is the very critical matter of who will package and handle fluid milk. The traditional handlers, the food chains, or perhaps the cooperatives. We have statistics which show that the large food chains are going into processing and manufacturing at an increasingly rapid rate. The food chains, be they the corporate chains, voluntary buying groups or cooperative chains; are now the major outlet for packaged fluid milk in the United States. They must handle 50 percent of the total packaged milk in the United States as a whole and nearly all of it in several major markets. Many people in the industry, indeed many of us who are academic specialists in milk marketing, feel a major concern over two problems that came from this: (1) whether the food chains will do as much to supply the demands that we know to exist as have the traditional handlers and (2) that they will not do much in research and development, promotion and even with handling the products adequately within stores as the traditional handlers have done. By adequately supplying the existing demand, I may use as an illustration the fact that the food chains would not carry on home deliveries. Many economists and others within the industry have said for years that the best way to sell the most milk would be to keep the very large consumer accounts on household

routes and let the smaller consumers buy from retail stores. We feel that this would maximize total sales. Howbeit you know the trends have been such that real competition on the part of the regular handlers has been focused on getting store accounts; they have in general done very little to establish pricing systems which would induce the large household buyer to have his milk delivered to his home. This is a fault of the industry.

One way or another this problem will have to be resolved in the next decade. It is not so clear how it will be resolved. The traditional handlers complain that the screws have been turned on their margins to the point where there is no longer adequate profit to be made by them in their store sales. This, of course, tends to depress the margins for household delivery as well. We are seeing the largest of the national dairy dealers becoming conglomerated. They give as the reason the fact that dairy margins are so low and the fact that the merger policy of the federal government has been such that they could not use merger as a method of growth.

I can see two things which may work in the direction of keeping the traditional handlers in the business of packaging and handling fluid milk. For one thing, most of the managers of the large regional coops would definitely prefer not to be in fluid milk processing and handling. They know that cooperatives have seldom done well in that field. For example, in Wisconsin since the early 1930's there have been about 30 cooperatives that have tried to go into the packaging and distribution business and only 3 or 4 are in it now. So I think the coops will do what they can to keep the handlers in business in preference to going into packaging and distribution themselves. In addition to this there are signs that the teamsters union will moderate their demands so that the regular dealers can reduce their distribution costs to something more nearly approaching the costs of the chain. I was talking with an executive of one of the large national dairy corporations a few days ago, and he went into some details about modification of labor demands and appeared very optimistic about it. So between these two things, I can see hope that traditional handlers will continue to package and handle milk. I can also see some hope that the traditional handlers will approach the problem of household deliveries with new imagination and interest. My hope here is based largely on what I have heard from Mr. Baumer and Mr. Jacobson of their research here on Ohio markets and also from what I hear of Hood's experimental routes in the New England area.

I can see on the horizon that something will be done about the free rider problem on research and development and promotion. This may be done by a system of compulsory state checkoffs such as we are considering again in the state of Wisconsin or it may be done by the regional coops themselves if they can handle the non-member problem. If a bargaining bill were passed much could be done under that. Much could be done under federal order, as is done in the New York-New Jersey order. I suppose there are other alternatives, but something must be done and the need is becoming so critical that various approaches will be tried until something works.

With the regional bargaining cooperatives now owning such substantial amounts of manufacturing capacity it seems likely that there may be more relationship between Grade A programs and programs for milk used for manufacturing, whether it be surplus Grade A or B. This has been long overdue.

It may come in the form of a Federal Stabilization Board. It may come in the form of a Federal Milk Control Program. It may come in the form of one National Milk Order which includes Grade B as well as Grade A. I don't know what form it may come in, but I do look for a much closer relationship than has existed before.

Within the next few years the biggest problem in manufacturing may be putting together under one ownership the tremendous volumes of milk necessary to take advantage of advanced technology. For example, let us look at the amounts of milk necessary to operate the size of plants that are technologically feasible.

The practical size limit on processing plants depends more on volumes of milk that can be brought together at one location at a reasonable hauling cost than on limits imposed by the most advanced manufacturing technology. With fluid milk and ice cream, distribution costs impose more of a limitation than hauling costs. However, new technology both in hauling and distribution are changing rapidly together with new methods of organizing an operation.

Examples of plant technology follow:

1. Continuous churns can now make 6,000 pounds of butter per hour. Two of these side by side together with a soft printer can make, print and package butter for less than three cents per pound where butterfat from at least a billion pounds of milk can be brought together.

2. Ice cream plants, fully automated, that will manufacture four to six million gallons of ice cream per year are now in operation. It is reported that these can make ice cream at lower cost when operated at 55 percent capacity than the most common sized plants when operated at 90 percent or so of capacity.

3. Automated milk packaging plants that can package two million quarts per day are a practical reality. The savings in packaging costs will offset the actual transportation cost for packaged milk for several hundred miles. These of course are minor in total cost of distribution but could be important to a big multi-unit operation of a regional or national dealer or chain store system.

4. Continuous cheese manufacturing operations make practical the making of 100,000 to 200,000 pounds of cheese per day in one automated plant.

5. Powdering plants that will handle 500 million pounds of skim per year have long been a practical reality.

Listing the above is not intended as an argument that all plants should be of such size for survival nor indeed for maximum engineering efficiency. It does, however, suggest that where milk supplies in a fairly dense region of milk production can be brought under one central management the posssibilities of cost savings with the latest technology are very dramatic.

I expect per capita demand to continue to decline. Vigorous efforts will be required to slow down the decline and the prospect of reversal appears bleak. The national milk mirage from which dairy has always benefitted is passing away and I expect milk looks like any other food product to the younger generation. I don't expect a rapid turn toward synthetic products, but I am casting doubt that people will reject new products solely on grounds that they are non-dairy.

Some people feel that milk prices should be held down to minimize consumer substitution for cheaper substitutes and synthetics. I can't see that the dairy industry can compete price-wise with the figures I have seen on the cost of substitutes. Margarine can be made and sold for profit at less than $.20 a pound. I expect that milk and cream substitutes can be made for less than half the cost of getting milk from cows. I would say to get a fair price for milk and dairy products, carry on vigorous research and development and promotion programs and that we will survive that way as well as any. Every industry in the world fears the substitution problem in one way or another.

LEGAL AND ECONOMIC IMPLICATIONS OF THE NEW DAIRY COOPERATIVE STRUCTURE

Robert E. Jacobson
Professor, Agricultural Economics
The Ohio State University

In direct response to the title of this presentation, there are two major implications to the increasing concentration of milk marketing cooperatives.

1. The Class I price implication has already been obvious for some time. The current $6.75 and $6.91 Class I prices in the Ohio Valley and the Eastern Ohio-Western Pennsylvania markets are 26 cents and 25 cents respectively above Federal order minimums. With 50 percent of a milk dealer's operating costs tied up in raw product costs, this is a major and obvious implication. Neither increased supplies of milk, nor any possible adoption of an economic price formula for Class I milk are apt to back the cooperatives off of this premium pricing policy.

2. The second implication is more intangible, is of a longer run consequence, and I advance it at this point in terms of a question. How far are some of these large, strong cooperatives going to move into fluid milk processing and distribution and become direct and powerful competitors to traditional milk dealers?

To evaluate these implications in some detail, let's look primarily at three things: (1) the structure that dairy co-ops have moved into recently; (2) the objectives that these cooperatives are pursuing; and (3) some of the constraints that may finally limit the cooperatives.

Organization of Dairy Cooperatives

For whatever the reasons, cooperative marketing activity among milk producers has been and continues to be more important than in any other farm enterprise. The total business volume of more than $4.5 billion per year of dairy cooperatives accounts for about 75 percent of the over $6 billion cash receipts to producers for milk and cream. Of all farm products sold by all cooperatives in the United States, milk accounts for one-third of the sales, thus ranking ahead of any other commodity. Grain, for example, is second, accounting for 22 percent of all co-op business.

Some changes among dairy cooperatives during the 1950-1968 period are recorded in the following table. 1/

1/ Statistics of Farmer Cooperatives, 1967-68, FCSRR-11, FCS-USDA, May, 1970.

Year	Number of Dairy Co-ops	Total Membership	Business Volume
1951	1,928	814,000	$1,934,000,000
1956	1,762	800,000	2,543,000,000
1960	1,541	663,000	3,056,000,000
1964	1,393	561,000	3,524,000,000
1968	1,100	434,000	4,505,000,000

There are essentially three things to observe in this table:

1. The number of dairy cooperatives is down, reflecting concentration.
2. Membership is down, reflecting the exit from dairy farming.
3. Business is up, reflecting both (a) higher prices, and (b) a higher proportion that co-op members are of all dairy farmers.

But the focus of all of the dairy cooperative growth and merger activity in the United States today is tied up in 3 or 4 organizations. For our purposes, we can think primarily of three of these merged organizations, all out of Ohio, and one federation, Great Lakes-Southern Milk, Inc., which fairly effectively blankets Ohio.

Merged Groups

1. Associated Milk Producers, Inc. -- at last count, stretched from Chicago to San Antonio, had 31,000 members, represented over 30 former separate cooperatives, and marketed over 11 billion pounds of milk annually.

2. Mid-America Dairymen, Inc. -- at last count, stretched from Minneapolis to St. Louis to Omaha, had 21,000 members, represented over 30 former separate cooperatives, and marketed over 7 billion pounds of milk annually.

3. Dairymen, Inc. -- at last count, stretched from Louisville to New Orleans, had 10,000 members, included 11 operating divisions, and marketed 4 billion pounds of milk annually.

Federated Group

Great Lakes-Southern Milk, Inc. -- at last count, stretched from Detroit to Miami, included 18 member cooperatives representing 34,000 producers, and marketed 13 billion pounds of milk annually. Dairymen, Inc. is a member cooperative of Great Lakes-Southern.

In identifying these various groups, I have failed to mention many major dairy marketing cooperative organizations such as Land O'Lakes Creameries, Inc., and others. But my point has been to focus more directly on bargaining groups basically which have seen recent rapid growth through merger or federation.

In summing up these consolidation activities, Glenn Lake, President of the National Milk Producers Federation, recently stated, "As a result of these efforts, seven cooperative groups can now speak, at least on some matters, for one-half of the U.S. milk supply. This is in contrast to more than 100 co-ops speaking for the same volume of milk and the same number of markets 5 years ago."

The question for this discussion is, "Why this merger activity?" An expression of the two basic objectives of dairy marketing cooperatives helps answer this.

1. To enhance the net incomes of producers, and
2. To provide market security to producers.

Al Ortego, the Economist for Dairymen, Inc., expanded on these in the recent NCR-70 seminar as follows:

> "The recent merger, consolidation, and federation of producer cooperatives are part of a continual struggle for market power to countervail the power on the opposite side of the market. Producers desire to achieve an influence capable of counter-acting or coping with that of regional and national processing firms and food retailing firms. Better organization over wider areas is needed to influence the increasingly important activities of the Federal government."

To say that the cooperatives have had recent successes in pursuing their objectives is at least partially correct.

1. On price, for example, Great Lakes-Southern has gained substantial premium moneys over what Federal order prices would have returned to them. In 1969, their premium money totalled $31 million; and in 1970, as Federal order prices climbed, their premium money amounted to over $22 million.

2. On security, for example, the recent bankruptcy of a dairy on the Detroit market lead to payments of only 12 cents on the dollar for 2 months milk for 158 non-members. Cooperative members supplying that plant got full payment.

To enhance the net income to producers or, in effect, to bargain (or announce), co-ops know they have to control the supply of milk. The co-ops have had some things help the situation, and they've done some things to help themselves in controlling supply in recent years. The four things to consider here include (1) milk production, (2) merger-federation, (3) stand-by pool, and (4) full supply contracts.

1. Milk production -- From 1964 through 1969, milk production in the U.S. dropped from 127.0 billion pounds to 116.3 billion pounds. No supply management programs or other restrictive type procedures were in effect. A combination of market forces was taking place. Cooperatives could neither take the blame nor the credit for this reduction in supply. But as milk production contracted, cooperatives found themselves in a much stronger position to control milk supplies. Now we are entering what appears to be a period of expanding milk supplies, and this could be a significant change in the bargaining picture. There still is no effective machinery available to limit total milk production.

2. Merger-federation -- Merger and federation are ways to stop competing for outlets and thereby to coordinate supplies, i.e., control supplies. Federation has done as much as merger in controlling supplies in

some instances. I was impressed when I read a copy of the Temporary Restraining Order that Borden secured against Central Ohio Cooperative Milk Producers Association this fall. Borden stated, among other things, that they were unable to get any supplies of milk in spite of rather intensive solicitation. The cooperative's diversion action was successful. This was supply control, and Great Lakes-Southern, through its Central Ohio member, had achieved this.

3. Standby pool -- The standby pool is an arrangement between cooperatives in markets that occasionally need extra milk (Ohio markets), or are afraid of getting outside milk dumped on them, and cooperatives in Wisconsin that do not have ready access to Class I outlets and thus have relatively low producer pay prices. Currently 2.25 cents per cwt. on all Class I milk in the participating deficit markets is being assessed to finance the standby pool. The basic intent, from an Ohio viewpoint, is to help keep control on other source supplies.

This touches on a major policy problem in the U.S. dairy industry for the next few years. This problem concerns the transition from manufacturing grade milk to Grade A milk, and the integration of this milk into the pricing system. Presently, 72 percent of the milk produced in the U.S. is Grade A, and this proportion has been increasing every year. Over one-half of the remaining manufacturing grade milk is produced in Wisconsin and Minnesota. Expectations are that the remaining manufacturing grade milk will convert to Grade A fairly rapidly. How these new Grade A supplies might be handled in a price regulatory program is the major question before the Federal order program today. This is also the major question confronting dairy cooperatives, and they are currently attempting to resolve it through the standby pool.

4. Full supply contracts -- The movement away from milk dealer involvement in direct milk procurement is getting pretty well documented. More and more full supply contracts, as the co-ops call them, are coming into the system. These contracts may or may not include service charges. But the point is, these contracts again are a means of co-ops getting on top of the supply situation, and they are therefore an important dimension of the bargaining program.

Immediate Bargaining Limits

There are two immediate limits on the bargaining front for dairy cooperatives.

1. Their own agreement on growth.
2. The non-member situation.

As for their own agreement on growth, the following observations on the Ohio and GL-SM situations appear relevant.

1. Milk, Inc. is pleased with its merger of January 1, 1970, and as it consolidates itself internally, further expansion is an obvious option.

2. Nobody seems to have their finger on the pulse in the Columbus, Dayton, and Cincinnati areas, so no predictions are possible.

3. Great Lakes-Southern Milk has asked itself the merger question, and as a federation, it can only preach. The 18 member cooperatives say they want to make some mergers, but they don't want to go all the way in a single merged organization.

But some people are impatient about this pace. At their 1970 annual meeting, President John Moser of Dairymen, Inc., "expressed his impatience with those who urge that local mergers take place within GL-SM before bringing all 18 dairy co-ops together in one marketing entity." 2/

At that same annual meeting, Manager Paul Alagia reported completion of a study on the feasibility of merging Associated Milk Producers, Inc. and Dairymen, Inc. This recommendation currently is being discussed at special Division meetings of Dairymen, Inc.

If this all sounds like some kind of merger fever, I think that describes in part the philosophy that some people in milk marketing cooperatives currently possess.

But all of the merger activity has not resolved the non-member problem for dairy cooperatives. There's no union shop in dairy farming, so non-membership is a kink in the co-op's supply control effort. In the two major Ohio Federal order markets, it is estimated that non-membership is as follows: (1) In the Ohio Valley market, 14 percent of the producers do not belong to a cooperative; (2) In the Eastern Ohio-Western Pennsylvania market, 25 percent of the producers do not belong to a cooperative.

While these estimates indicate that most producers do belong to a cooperative, it is a fact that the distribution of non-members, from a co-op point of view, is bad. There are a couple of historic non-member islands in the Cleveland-Akron market. And in Southeastern Ohio, a significant non-member problem is further aggravated by a splinter group of organized producers.

If cooperatives don't have the members, they can't control the supply. So what are they going to do about it? One vehicle they've been looking to is Federal legislation, a la the National Labor Relations Act. In speaking to this point, one leader in a major regional cooperative recently said, "Unless Congress passes legislation which grants agriculture similar rights to those granted labor by the Wagner and other legislative acts, then merger activity among the larger milk producer organizations will probably be restricted within 3 to 5 years. Producer organizations and cooperatives in general are making a concerted effort to have a national agricultural bargaining act passed in Congress."

Second Implication: Co-op Processing-Distribution

Let me say something only briefly on the point of dairy cooperative involvement in fluid milk processing-distribution. This question sort of

---

2/ Hoard's Dairyman, January 10, 1971, p. 34.

comes out of some trends we are seeing. For example, the census figures on fluid bottling plants in the United States listed 8,484 plants in 1948 and 2,840 plants in 1969. In another dimension, 34 grocery chains have now set up their own milk processing plants (51 plants), and these plants do an estimated 19 percent of all fluid processing in the U.S.

The question becomes, "Are the cooperatives going to move into fluid milk processing-distribution, what with survival problems among milk dealers and potential further shifts of bargaining power to food chains?"

There is no explicit co-op policy available at the present time to help us answer this question. In some instances, dairy co-ops are involved in processing-distribution because they now are basically trying to recover costs from sunk investments. In other instances, co-ops have taken over the operations of milk dealers, more to salvage a market for the co-op's producers than to strategically involve themselves in these marketing functions.

But in further responding to this question, let me read what Paul Alagia reported to the membership of Dairymen, Inc. on this matter at their 1970 annual meeting.

> "....Since it appears that vertical integration by retail and private labeling will become even more important in the future, we can expect further attrition by the traditional milk processing firm from the dairy industry. This means that milk will be processed and distributed by retail chains or by producer organizations for distribution through such chains.
>
> "Dairymen, Inc., believes that with its present bottling operations, it will be able to gain valuable experience so that it can better decide the road to take in the future with respect to the processing and distribution of fluid milk. It appears obvious that the current trend will continue. There will be fewer and fewer processor-distributor milk plants than there are today, and more and more retail chain processing plants with the result that the dairy farmer should anticipate getting more involved in the bottling business if he is to market his product all the way from the cow to the consumer. If, and when, producers are required to process and distribute their own production on a large scale, DI will have the experience from which to draw and to do the job properly." 3/

3/ Alagia, D. Paul Jr., "Report to Membership of Dairymen, Inc.," Dairymen, Inc. News, Vol. 3, No. 3, December, 1970, pp. 5-6.

Finally, when does this all end so far as growth in size and power of dairy cooperatives is concerned? Let me advance three somewhat inter-related dimensions to this question. These include (1) membership, (2) public, and (3) legal.

1. Membership - The leadership of cooperatives knows, but sometimes forgets, that it had better not get very far out in front of its members. Mr. John Gage, Legal Counsel for Mid-America Dairymen, recently spoke to this point in part, and he also indicated how tightly the relationship between members and the organization would have to be maintained. He stated, "The strength or guts of a milk marketing association's program lies in membership stability and in agreements which can and will be enforced in the courts if necessary to insure control over a sufficient volume of milk to continue an effective program. With this, an association can ride out the adversities and overcome them. Without it, it may be building on a foundation of quicksand regardless of its assets and membership equities. Any serious legal problem or setback may cause membership erosion, which could snowball very rapidly. The terms and enforcement of membership and marketing agreements are highly important, and the same applies to other agreements such as hauling contracts which give control and continuity to the milk marketing program. It should be kept in mind that many associations have in the past been held together largely by local pride, but that this factor may have a reverse twist in large regional associations for a while at least." 4/

The question for the co-ops here is, "Can we get too big to maintain membership stability?"

2. Public - In referring to the public as a type of limit on the power of cooperatives, I'm basically thinking of consumerism at this point. Already, the Federal order program has come under some scrutiny by consumer spokesmen (Nader). Classified prices with higher Class I prices in a sense discriminating against low income consumer, are a part of this question. With increasing emphasis on the nutrition question, this type of economic price discrimination may be subject to further inquiry. The question this generates for our discussion is, "How long could large cooperatives stand in the cross-fire if consumerism should start analyzing the monopoly powers of cooperatives together with their Capper-Volstead exemption in the sensitive area of food price?"

3. Legal - While the legal limits on cooperative power continue to be subject to question, the following relatively definitive statement on this from the FTC indicates current policy, particularly with respect to co-op mergers:

". . . it would seem that the cooperatives relative immunity from the anti-trust laws has become increasingly narrow. The case law has generally tended to examine the facts in each case despite the strong arguments of cooperative's counsel that to do so violates a sacred precinct of cooperative activity.

4/ Gage, John C., "How To Steer Clear of Legal Reefs in the Uncharted Future", Proceedings of 25th Annual Midwest Milk Marketing Conference, University of Missouri, April, 1970, p. 45.

Should this trend continue and should such a merger among cooperatives occur in a competitive setting clearly indicative . . . of a substantial lessening of competition . . ., then I believe that it is not at all inconceivable that a Section 7 (anti-merger) case based on a strictly inter-cooperative merger might be undertaken. Although this may sound like heresy, I think that you would agree that even with cooperatives, an anti-competitive effect could result from a particular merger. If and when such an effect is the product of an inter-cooperative merger, I believe the parties will be hard pressed to argue that the Congress . . . in the Capper-Volstead Act, intended to protect circumstances detrimental to competition." 5/

In summary, we've talked about a lot of growth and power and about some limits on growth and power. The member situation, the non-member situation, public reaction, and legal considerations are basic dimensions of this activity. The only safe prediction at this point is that the pace of action and reaction on dairy cooperative growth in these next few years is certainly not going to be on the quiet side.

5/ Boyd, William J., Jr., "Mergers and Cooperatives", Proceedings of 24th Midwest Milk Marketing Conference, University of Kentucky, April, 1969, p. 5.